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Directive 86-28: Excess Part B Adjusted Gross Income Deductions Trade Or Business Deductions

Facts: Taxpayer Adams has two businesses: one plumbing and the other painting. Adams as Part B (5%) net income of \$5,000 from the plumbing business which he reports on a Schedule C. Adams' business deductions from his painting business exceed his painting income by \$15,000. He reports this amount as a loss on a second Schedule C. He combines the income from the plumbing business and the loss from the painting business and reports a net business loss of \$10,000 on his Form 1. Adams also has Part A (10%) income. He has a \$5,000 net gain from the sale of a capital asset used in his plumbing business. For purposes of this Directive it is assumed that the gain from this sale is effectively connected with the active conduct of his plumbing business. In addition, he has dividend income which is unrelated to either of his businesses.

Issue 1: May Adams use his Part B excess business deductions to offset his Part A income?

Issue 2: How much of Adams' Part A income may be offset?

Discussion: Generally, taxpayers may not use excess Part B deductions to offset their Part A income. However, Massachusetts law provides that a taxpayer may use the excess of Part B deductions over Part B income to offset Part A income in the limited situation where two requirements are met. G.L. c. 62, § 2(c)(1).

The first requirement relates to the Part B deductions. The deductions must be those taken against Part B gross income to compute Part B adjusted gross income. (AGI deductions). G.L. c. 62, § 2(c)(1). These deductions are those allowed under section 62 of the Internal Revenue Code, with certain modifications. G.L. c. 62, § 2(d). The section 62 deductions include, among other deductions, the deduction for expenses incurred in the taxpayer's trade or business. I.R.C. § 62(1). Thus, on the facts presented, Adams' \$10,000 loss which represents the excess of his business deductions over his Part B income satisfies the first requirement.

The second requirement relates to the nature of the Part A income. To qualify for the offset, the Part A income must be effectively connected with the active conduct of the taxpayer's trade or business. G.L. c. 62, § 2(c)(1). There is no requirement that the Part A income be connected with the same trade or business which gave rise to the excess deductions. The taxpayer's Part A income which is unrelated to a trade or business may not be offset by the excess deductions.

Directive 1: Adams may use the \$10,000 loss representing the excess of his Part B business deductions over his Part B income to offset his Part A income.

Directive 2: Adams' Part A net capital gain of \$5,000 can be offset by the excess Part B business deductions because the capital gain is effectively connected with the active conduct of his plumbing business. Adams cannot offset his 10% dividend income with the remaining deductions because the dividend income is unrelated to his businesses.

Reference: G.L. c. 62, § 2(c)(1), (d); I.R.C. § 62(1).

/s/Ira A. Jackson
Ira A. Jackson
Commissioner of Revenue

31 December 1986

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This Directive represents the official position of the Department of Revenue on the application of the law to the facts as stated. The Department and its personnel will follow this Directive, and taxpayers may rely upon it, unless it is revoked or modified pursuant to 830 CMR § 62C.01(5)(e). In applying this Directive, however, the effect of subsequent legislation, regulations, court decisions, Directives, and TIRs must be considered, and Department personnel and taxpayers may rely upon this Directive only if the facts, circumstances and issues presented in other cases are substantially the same as those set forth in this Directive.